

Supreme Court, U.S.  
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In The  
**Supreme Court of the United States**  
October Term, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALES,  
 HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,  
 HON. LLOYD DOGGETT, HON. JOHN CORNYN,  
 HON. BOB GAMMAGE, HON. CRAIG T. ENOCH,  
 HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO  
 JUSTICE FOUNDATION, AND W. FRANK NEWTON, IN HIS  
 OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS  
 EQUAL ACCESS TO JUSTICE FOUNDATION,

*Petitioners,*

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.  
 SUMMERS, AND MICHAEL J. MAZZONE,

*Respondents.*

**Petition For Writ Of Certiorari  
 To The United States Court Of Appeals  
 For The Fifth Circuit**

**PETITIONERS' REPLY TO RESPONDENTS'  
 MEMORANDUM IN RESPONSE TO THE PETITION**

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**PETITIONERS' REPLY TO RESPONDENTS'  
MEMORANDUM IN RESPONSE TO THE PETITION**

The Petitioners, the individual Justices of the Texas Supreme Court, the Texas Equal Access to Justice Foundation, and W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation, respectfully file this Reply to Respondents' Memorandum in Response to the Petition to show the Court, further, the reasons a writ of certiorari should issue to address both of the Questions Presented in the Petition filed and docketed in this case on April 4, 1997.

**I. RESPONDENTS HAVE AGREED THAT THIS  
COURT SHOULD GRANT THE WRIT TO  
RESOLVE A CIRCUIT CONFLICT ON A RECUR-  
RING QUESTION OF NATIONAL IMPORTANCE  
REGARDING WHETHER IOLTA INTEREST IS A  
COGNIZABLE PROPERTY INTEREST OF THE CLI-  
ENT OR LAWYER UNDER THE FIRST OR FIFTH  
AMENDMENTS TO THE U.S. CONSTITUTION**

By their Memorandum in Response to the Petition, Respondents have agreed that the conflict between the Circuits over the ownership of IOLTA-derived interest poses a recurring question of national importance that is squarely presented in this case. Resp. Br. p. 6. Respondents also agreed that the conflict involves a legal question, and that no further proceedings below are required to develop facts instructive on the issue presented. Resp. Br. p. 11.<sup>1</sup>

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<sup>1</sup> There is no basis for Respondents' assertion that if the Fifth Circuit is reversed, "the lower courts would need to

The conflict between the Circuits focuses precisely on IOLTA's primary premise that clients have no reasonable expectation to earn interest on funds deposited in IOLTA accounts. As set forth in the various amicus briefs in support of the Petition, resolution of this conflict is of national importance because the premise of all IOLTA programs has been called into question. The First and Eleventh Circuit Courts, seven state supreme courts, and a California appellate court all held that the interest earned on funds deposited in IOLTA accounts is not clients' property.<sup>2</sup> The Fifth Circuit, however, held that

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address whether the clients could in fact accumulate interest on short-term and nominal deposits absent the strictures of the IOLTA regulations." Petitioners have repeatedly acknowledged that if client funds deposited in an individual or pooled account can legally and ethically earn a net return to the client in *any* amount, the funds *are not* eligible for deposit into an IOLTA account. (R. Vol. I, p. 159; R. Vol. IV, p. 529; R. Vol. VI, p. 907.) Accordingly, if there is *any* legal and ethical way by which client funds may earn interest for the client, the funds are not eligible for placement in an IOLTA account. Thus, by definition of the IOLTA program, the inquiry suggested by Respondent is irrelevant.

<sup>2</sup> *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987); *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re N.H. Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minn. State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *see also Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984), cert. denied sub nom., *Chapman v. State Bar of Cal.*, 474 U.S. 848 (1985) (intermediate California appellate court upheld IOLTA Program against constitutional challenge).

IOLTA interest belongs to clients because they are the owners of the principal, regardless whether the clients had any reasonable expectation to receive interest on that principal after depositing the funds with their lawyers. 94 F.3d 996, 1002-1003 (1996); Pet. App. pp. 12-13. By abandoning the "reasonable expectation" component of this Court's takings analysis, the Fifth Circuit's decision creates a split among the Circuits that goes to the heart of this Court's takings jurisprudence. The Court should grant the writ to resolve this significant conflict.

## II. THIS CASE PRESENTS THE EQUALLY IMPORTANT QUESTION WHETHER THE FIFTH CIRCUIT ADEQUATELY DEFERRED TO STATE LAW UNDER PRINCIPLES OF COMITY AND FEDERALISM

The single issue decided by the Fifth Circuit was whether a property right exists in IOLTA-derived interest antecedent to Respondents' constitutional claims. To maintain a cooperative judicial federalism, and avoid premature adjudication of constitutional questions, it is important to avoid federal court error in deciding state law questions antecedent to constitutional issues. *Arizonans for Official English v. Arizona*, 65 U.S.L.W. 4169 (March 3, 1997). As discussed more fully on pages 19-22 of the Petition, in determining whether or not a property right exists, the Fifth Circuit should have based its decision on a meaningful analysis of state law to determine the rule that the Texas Supreme Court would probably

follow. The Fifth Circuit should not have indulged its own preferences as to what is a more enlightened, or less "shortsighted," legal rule; for there is no federal general common law of property on which to base a determination that such a property right exists.<sup>3</sup> *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), *see also Oregon Ex. Rel. State Land Board v. Corvallis Sand & Gravel Co.*, 429 U.S. 363, 378-379 (1977) (property ownership is not governed by a general federal law, but by state law) (Rehnquist, J.).

The Fifth Circuit, however, did little more than pay token homage to state law, merely reciting the generic rule that "interest follows principal" found in *Sellers v. Harris Co.*, 483 S.W.2d 242 (Tex. 1972) (approximately \$6,000 in interest earned per month on \$1,000,000 in

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<sup>3</sup> The Fifth Circuit sought to create its own federal general common law of property when it paid too little deference to Texas law by failing to assess how the Texas Supreme Court would rule on the specific property question in issue. The second of the "Questions Presented" by the Petition thus lays before this Court the issue whether there exists a body of federal general common law upon which the Fifth Circuit could have validly rested its decision, rather than following principles of comity and federalism that require deference to determinations of the issue by the Texas Supreme Court. Contrary to Respondents' assertion, the Fifth Circuit's failure to pay adequate deference to Texas law was brought to the Fifth Circuit's attention on petition for rehearing, "[i]n light of the Texas Supreme Court's specific finding that certain client funds are eligible for deposit in an IOLTA account because interest income cannot reasonably be earned to benefit the clients, the Panel misapplied or paid too little deference to the Texas Supreme Court's pronouncement of Texas law." Petition for Panel Rehearing p. 8. By footnote to that same statement, Petitioners urged the Panel to "certify the question to the Supreme Court of Texas."

interpleaded funds). *Sellers* is quite clearly distinguishable upon a critical point, for in that case there was obviously a reasonable expectation of receiving interest beyond the costs of administration of the funds. The Fifth Circuit failed to consider whether the Texas Supreme Court would find the generic rule "interest follows principal" has exceptions under Texas law, particularly where there is no reasonable expectation of receiving interest. The Court also failed to explore the rationale upon which the Texas Supreme Court founded the Texas IOLTA Program and the property interest implications of that rationale, and failed to consider the specific finding by the Texas Supreme Court with respect to funds eligible for deposit in IOLTA accounts that "interest income cannot reasonably be earned to benefit individual clients for whom the funds are held." Pet. App. p. 56a. The Fifth Circuit simply held that IOLTA interest belongs to clients because interest follows principal. 94 F.3d at 1002; Pet. App. p. 12.

Respondents attempt to disguise this lack of deference to Texas law by arguing that the Fifth Circuit based its decision on constitutional law, as this Court did in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). However, the sole issue decided by the Fifth Circuit was whether clients have a property right in interest earned on their funds deposited in IOLTA accounts. As this Court has repeatedly noted, whether a property right exists is not determined by constitutional law. *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 538 (1985); *Webb's*, 449 U.S. at 161; *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Moreover, the issue in *Webb's* was not whether a property right in earned interest existed, but whether a

state statute could constitutionally direct that the interest accrue to the state. This Court held that a state cannot recharacterize private funds into public funds and avoid a takings claim. *Webb's*, 449 U.S. at 164. Thus, the application of constitutional law in *Webb's* was whether or not property was taken, not whether a property right existed under state law. Indeed, as noted in the Petition, *Webb's* is easily distinguishable on its facts, because there was a manifest reasonable expectation of the principal funds at issue in *Webb's* earning interest in excess of the costs of administration. Moreover, this Court made clear the narrow confines of its decision.<sup>4</sup> Because the Fifth Circuit's decision below was not based on application of constitutional law, nor on a determination of how the Texas Supreme Court would rule on the existence of a property right in IOLTA interest, the question whether the Fifth Circuit paid adequate deference to state law is raised and should be addressed by this Court.

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## CONCLUSION

Both questions presented in the Petition warrant this Court's consideration. If left unresolved, the Circuit conflict threatens to undermine important programs across the nation that affect millions of people. The conflict also

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<sup>4</sup> "This case presents the issue whether it is constitutional for a county to take as its own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court, when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry." *Webb's*, 449 U.S. at 155-156.

goes beyond the IOLTA context by calling into doubt this Court's long-held component of takings jurisprudence – that an expectation of property subject to constitutional protection must be reasonable. Moreover, the decision of the court of appeals below poses the important question of the deference to be afforded state law by a federal court, particularly when state law is determinative of an issue antecedent to constitutional claims.

For the foregoing reasons, and the reasons set forth in the Petition, a writ of certiorari should issue on both questions presented in the Petition, the decision of the court of appeals below should be reversed, and the decision of the district court affirmed in all respects.

Respectfully submitted,

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